

Financial statements and report of independent certified public accountants

State of Hawaii, Department of Health

June 30, 2004

March 31, 2005

Director of Health
State of Hawaii
Department of Health

Dear Madam:

This is our report on the financial audit of the Department of Health, State of Hawaii (Department) for the year ended June 30, 2004. Our audit was performed in accordance with the terms of our contract with the Department and with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of State and Local Governments, and Non-Profit Organizations* and the *Compliance Supplement for Single Audits of State and Local Governments*.

OBJECTIVES OF THE AUDIT

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the Department's financial statements for the year ended June 30, 2004, and to comply with the requirements of OMB Circular A-133, which establishes audit requirements for State and local governments and non-profit organizations that receive federal financial assistance.

More specifically, the objectives of the audit were as follows:

1. To satisfy the audit requirements of OMB Circular A-133.
2. To provide a basis for an opinion on the fairness of the presentation of the Department's financial statements.
3. To determine whether expenditures and other disbursements have been made and all revenues and other receipts to which the Department is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii and the Federal Government.
4. To determine whether the Department's internal control structure is adequate in assuring that there is effective control over and proper accounting of revenues, expenditures, assets, and liabilities, and to ensure that the Department has established sufficient controls to properly manage federal financial assistance programs and to comply with the applicable laws and regulations.

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Department of Health
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5. To determine whether the Department has complied with the laws and regulations that may have a material effect on the combined financial statements and on each major federal financial assistance program of the Department.

SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants and *Government Auditing Standards*, issued by the Comptroller General of the United States. The scope of our audit included an examination of the transactions and accounting records of the Department for the year ended June 30, 2004. In addition, we reviewed the existing internal control structure to provide us with a basis to report whether the Department had complied with the material terms and conditions of federal grant agreements.


ORGANIZATION OF THE REPORT

This report is presented in four parts as follows:

- Part I – The financial statements of the Department for the year ended June 30, 2004 and our opinion on the financial statements.
- Part II – Our reports on compliance and internal control.
- Part III – Schedule of findings and questioned costs.
- Part IV – Response of the affected agency.

We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the officers and staff of the Department of Health, State of Hawaii.

Very truly yours,

A handwritten signature in black ink, reading "Grant Stewart" followed by a stylized flourish.

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PART I
FINANCIAL SECTION

Report of Independent Certified Public Accountants

Director of Health
Department of Health
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Department of Health, State of Hawaii (Department) as of and for the year ended June 30, 2004, which collectively comprise the Department's basic financial statements as listed in the contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the Auditing Standards Board of the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note A, the financial statements of the Department of Health, State of Hawaii, are intended to present the financial position and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2004, and the changes in its financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Department, as of June 30, 2004, and the

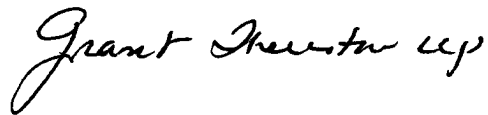
Director of Health
Department of Health
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respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note I, the net assets as of July 1, 2003 have been restated to correct an error.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 14, 2005 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis and budgetary comparison schedules on pages 7 to 17 and pages 46 to 48, respectively, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in black ink, reading "Grant Thornton LLP". The signature is written in a cursive, flowing style.

Honolulu, Hawaii
March 14, 2005

State of Hawaii
Department of Health

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2004

This section of the State of Hawaii, Department of Health's (Department) annual financial report presents management's discussion and analysis of the Department's financial performance during the fiscal year that ended on June 30, 2004. Please read it in conjunction with the Department's financial statements, which follows this section.

OVERVIEW OF THE FINANCIAL STATEMENTS

This financial report consists of four (4) parts: this management's discussion and analysis, the basic financial statements including the related notes to the financial statements, other required supplementary information, and other information. These components are described below:

Basic Financial Statements

The basic financial statements include two kinds of statements that present different views of the Department:

- The first two statements are government-wide financial statements that provide information about the Department's overall financial position and results of operations. These statements, which are presented on an accrual basis of accounting, consist of the Statement of Net Assets and the Statement of Activities.
- The remaining statements are fund financial statements of the Department's governmental funds, for which activities are funded primarily from appropriations from the State of Hawaii, by revenues from the tobacco settlement agreement, and federal grants; the Department's proprietary funds, which consist of revolving loan funds and operate similar to business activities; and the Department's fiduciary funds. The governmental funds are presented on a modified accrual basis of accounting. The proprietary and the fiduciary funds are presented on an accrual basis of accounting.
- The basic financial statements also include a "Notes to Financial Statement" section that explains some of the information in the Department-Wide and the Fund financial statements and provides more detailed data.
- The "Notes to the Financial Statements" are followed by Budgetary Comparison Schedules for the General Fund and Tobacco Settlement Fund which are supplementary information required by the Governmental Accounting Standards Board

State of Hawaii
Department of Health

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2004

OVERVIEW OF THE FINANCIAL STATEMENTS (continued)

Government-Wide Financial Statements

The government-wide statements report information about the Department as a whole using accounting methods similar to those used by private sector companies. The statement of net assets provides both short term and long-term information about the Department's financial position, which assists in assessing the Department's economic conditions at the end of the fiscal year. All of the current year revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid. The government-wide financial statements include two statements:

- The *statement of net assets* presents all of the Department's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases and decreases in the Department's net assets may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating.
- The *statement of activities* presents information showing how the Department's net assets changed during the most recent fiscal year.

The government-wide financial statements of the Department are divided into two categories:

- Governmental activities – The activities in this section are primarily supported by State of Hawaii appropriations, funds from the tobacco settlement, federal grants, and fees.
- Business-type activities – These functions normally are intended to recover all or a significant portion of their costs through user's fees and charges to external users. These activities include the Department's two revolving loan funds.

Fund Financial Statements

The fund financial statements provide more detailed information about the Department's most significant funds and not the Department as a whole. The financial activities of the Department are recorded in individual funds. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Funds are reported as a major fund or a non-major (other) fund. The Governmental Accounting Standards Board (GASB) issued Statement 34, *Basic Financial Statements – Management's Discussion and Analysis- for State and Local Governments*, which sets forth the minimum criteria for the determination of major funds. The non-major funds are combined in a column in the fund financial statements.

State of Hawaii
Department of Health

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2004

OVERVIEW OF THE FINANCIAL STATEMENTS (continued)

Fund Financial Statements (continued)

The Department has three types of funds:

- **Governmental Funds:** Governmental funds are used to account for essentially the same functions reported in the governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental financial statements focus on near-term inflows and outflows of expendable resources as well as on the balances of expendable resources available at the end of the fiscal year.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. Both governmental fund balance sheet and statement of revenues, expenditures, and changes in fund balance provide a reconciliation to facilitate comparison between governmental funds and governmental activities in the government-wide financial statements.

- **Proprietary Funds:** Proprietary funds are used to report activities that operate more like those of commercial enterprises. They are known as enterprise funds because they charge fees for services provided to outsiders. They are used to report the same functions presented as business-type activities in the government-wide financial statements. The Department uses enterprise funds to account for the operations of its two revolving loan funds each of which are considered to be major funds of the Department.
- **Fiduciary Funds:** The trust funds account for net assets held in a trustee capacity for others. These funds are not reflected in the government-wide financial statements since these resources are not available to support the Department's programs.

Notes to Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements follow the basic financial statements.

Required Supplementary Information

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information. This section includes a budgetary comparison schedule, which includes a reconciliation for the general fund and tobacco settlement fund, comparing the excess of revenues over expenditures presented on a budgetary basis to the excess (deficiency) of revenues over expenditures presented in conformity with GAAP as presented in the governmental fund financial statements. This management's

State of Hawaii
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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2004

discussion and analysis is also Required Supplementary Information that is required to be presented preceding the financial statements.

FINANCIAL HIGHLIGHTS

- The Department's total net assets increased by approximately \$3.60 million from \$432.67 million, as of June 30, 2003 to \$436.27 million as of June 30, 2004. The total increase in net assets was attributed to an increase in the Department's business type activities of \$13.19 million and decrease in governmental activities of \$9.59 million during the year.
- The Department's governmental funds reported an aggregate decrease in fund balance of \$6.18 million during the year and totaled \$98.15 million at June 30, 2004.
- The Department's proprietary funds, consisting of two revolving loan funds, reported an increase in net assets of \$13.19 million for 2004. Total net assets were \$290.89 million at June 30, 2004.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

This section includes condensed Department-wide financial information.

Statement of Net Assets
June 30,
(\$000)

| | Governmental Activities | | Business-type Activities | | Total | |
|----------------------------------|----------------------------|--------------------|-----------------------------|--------------------|------------------|--------------------|
| | 2004 | 2003 (restated) | 2004 | 2003 (restated) | 2004 | 2003 (restated) |
| Current assets | \$121,621 | \$122,805 | \$133,391 | \$114,943 | \$255,012 | \$237,749 |
| Capital assets | 69,907 | 72,889 | 268 | 351 | 70,175 | 73,241 |
| Other assets | — | — | 157,283 | 162,446 | 157,283 | 162,446 |
| Total assets | <u>\$191,528</u> | <u>\$195,694</u> | <u>\$290,942</u> | <u>\$277,741</u> | <u>\$482,470</u> | <u>\$473,436</u> |
| Current liabilities | \$ 31,514 | \$ 26,888 | \$ 55 | \$ 49 | \$ 31,569 | \$ 26,937 |
| Long term liabilities | 14,623 | 13,824 | — | — | 14,623 | 13,824 |
| Total liabilities | 46,137 | 40,712 | 55 | 49 | 46,192 | 40,761 |
| Net assets | | | | | | |
| Invested in capital assets | 69,907 | | | | | |
| | | 72,889 | 268 | 351 | 70,175 | 73,241 |
| Restricted | 58,671 | 61,103 | 290,619 | 277,341 | 349,290 | 338,444 |
| Unrestricted | 16,813 | 20,990 | — | — | 16,813 | 20,990 |
| Total net assets | <u>145,391</u> | <u>154,982</u> | <u>290,887</u> | <u>277,692</u> | <u>436,278</u> | <u>432,674</u> |
| Total liabilities and net assets | <u>\$191,528</u> | <u>\$195,694</u> | <u>\$290,942</u> | <u>\$277,741</u> | <u>\$482,470</u> | <u>\$473,436</u> |

State of Hawaii
Department of Health

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2004

As noted earlier, changes in net assets may serve over time as a useful indicator of the Department's financial position. As of June 30, 2004, the Department's total net assets was approximately \$436.3 million.

At June 30, 2004, in addition to cash in the state treasury approximating \$235.8 million, the Department had total loan receivables from county governments in the amount of \$169.1 million arising from its two revolving loan funds. The Department had total liabilities of \$46.2 million at June 30, 2004 of which \$29.9 million relates to accrued wages and employee benefits payable. Approximately \$15.9 million liabilities relate to vouchers and contracts payables. At June 30, 2004, restricted net assets were \$349.3 million. The restrictions arise from legal and contractual agreements.

Statement of Activities
Year ended June 30,

| | Governmental Activities | | Business-type Activities | | Total | |
|------------------------------------|----------------------------|--------------------|-----------------------------|--------------------|------------------|--------------------|
| | 2004 | 2003 (restated) | 2004 | 2003 (restated) | 2004 | 2003 (restated) |
| Revenues | | | | | | |
| Program revenues | | | | | | |
| Charges for services | \$ 9,255 | \$ 9,466 | \$ 6,068 | \$ 5,938 | \$ 15,323 | \$ 15,405 |
| Operating grants and contributions | 97,825 | 87,059 | 5,589 | 10,310 | 103,414 | 97,369 |
| General revenues | | | | | | |
| State appropriated funds | 341,802 | 317,485 | — | — | 341,802 | 317,485 |
| Nonimposed fringe benefits | 31,878 | 30,535 | — | — | 31,878 | 30,535 |
| Tobacco settlement funds | 38,490 | 43,523 | — | — | 38,490 | 43,523 |
| Environmental fees and taxes | 8,131 | 6,720 | — | — | 8,131 | 6,720 |
| Total revenues | 527,381 | 494,788 | 11,657 | 16,248 | 539,038 | 511,036 |
| Expenses | | | | | | |
| General administration | 26,435 | 25,291 | — | — | 26,435 | 25,291 |
| Environmental health | 38,350 | 36,581 | 2,160 | 2,028 | 40,510 | 38,609 |
| Behavior health | 206,441 | 193,218 | — | — | 206,441 | 193,218 |
| Health resources | 252,700 | 250,410 | — | — | 252,700 | 250,410 |
| Total expenses | 523,926 | 505,500 | 2,160 | 2,028 | 526,086 | 507,528 |
| Excess before transfers | 3,455 | (10,712) | 9,497 | 14,220 | 12,952 | 3,508 |
| Transfers | (13,045) | (21,744) | 3,697 | 3,645 | (9,348) | (18,099) |
| Change in net assets | (9,590) | (32,456) | 13,194 | 17,865 | 3,604 | (14,591) |
| Net assets-beginning of year | 154,982 | 187,438 | 277,692 | 259,827 | 432,674 | 447,265 |
| Net asset-end of year | <u>\$145,391</u> | <u>\$154,982</u> | <u>\$290,887</u> | <u>\$277,692</u> | <u>\$436,278</u> | <u>\$432,674</u> |

State of Hawaii
Department of Health

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2004

Governmental activities decreased the Department's net assets by \$9.6 million. The decrease was primarily due to depreciation expense of \$4.9 million and transfers of \$13 million.

Revenues of the Department's business-type activities were primarily from charges for services, program investment income and federal assistance program funds and state matching funds. Charges for services consist primarily of administration loan fees and interest income on loans related to the Department's two revolving loan programs. The majority of the program investment income is from income earned from participation in the State Treasury Investment Pool System.

For the fiscal year ending June 30, 2004, business-type activities increased the Department's net assets by \$9.5 million before transfers. Key elements of this increase are as follows:

- The Department received \$2.9 million and \$3.7 million from the federal and state governments, respectively.
- The Department earned \$4.1 million and \$1.9 million from interest income and loan fees from its outstanding loans, respectively.
- The Department earned \$2.7 million from investments.

Total Department-wide expenses for 2004 were \$526.1 million of which \$523.9 million was for governmental activities. Overall the Department is organized into four major administrations.

Financially, the largest administration is the Health Resources Administration that expended approximately 48% of all expenses. A major program accounted for in this administration is the Healthy Hawaii Initiative. This program seeks to prevent chronic diseases such as heart disease, cancer and diabetes utilizing tobacco settlement funds for programs that work to decrease tobacco use, improve nutrition and promote physical activities. Other significant programs include the Disease Outbreak Control Division which utilizes state and federal bioterrorism funds for emergency response to disease outbreaks, and the Injury Prevention and Control Program that includes the state's mandated Emergency Medical Services funds. The Family Health Services Division that administers the state's Healthy Start and Early Intervention programs for children and the Community Health Division that provides Public Health Nursing Services are responsive to requirements of the Felix lawsuit. The Developmental Disabilities Division that services the disabled clients in the state is also addressing the conditions of the Makin Settlement. As the DOH is responsibly adhering to the court settlement conditions, these are additional reasons why this administration expends the majority of departmental funds.

The Behavioral Health Services Administration expended a significant 39% of departmental funds. This administration is responsible to provide available and coordinated mental health and substance abuse treatment and prevention programs. Programs within this administration are the Adult Mental Health

State of Hawaii
Department of Health

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2004

Division (AMHD) that includes the Hawaii State Hospital and Community Mental Health Plan, the Child and Adolescent Mental Health Division (CAMHD), and Alcohol and Drug Abuse Division (ADAD). All of these programs are critical as they provided priority services: AMHD continues to work on the requirements of the Department of Justice court ordered agreement to improve the Hawaii State Hospital and Community Mental Health Plan, CAMHD responds to the declining requirements of the Felix case, and ADAD responds to the Administration's Ice (drug) initiative and the additional funding appropriated.

The Environmental Health Administration is responsible for the management of the clean air, clean water, solid and hazardous waste, public sanitation, vector control, and purity of food and drugs. It expends approximately 7% of the departmental funds. The programs are heavily federally funded through the Environmental Protection Agency. This administration also manages the Water Pollution Control Revolving Fund and the Drinking Water Treatment Revolving Fund.

Finally, the fourth Administration within the Department is the General Administration unit. It provides the overall leadership, administrative support units, and oversight to the three district health offices and to the five administratively attached agencies to the DOH. This administration expends approximately 5% of the departmental funds.

The significant changes in our financial statements from 2003 to 2004 are generally attributable to the requirements of the mandated court settlements and other non-discretionary items. Of significance are the additional revenues and expenditures for the Adult Mental Health and Hawaii State Hospital programs, the Developmental Disabilities Division's efforts to meet the requirements of the Makin Settlement to take more clients off the wait lists and into their program, and the Children with Special Health Needs expenditures to address the needs of the Early Intervention Program tied to the Felix Settlement. It is noted that the Child and Adolescents Mental Health Division has stabilized its Felix client counts and reassigned autistic children to the DDD and others to the Department of Education which have resulted in a significant reduction in this program's expenditures.

The other significant increases in expenditures are due to the Alcohol and Drug Abuse Program's increased level of activities to implement the Administration's priority Ice (drug) program, and the Epidemiology program's growth due to federal Bioterrorism program funds.

Significant reductions in funding levels are being experienced by the Tobacco Settlement Special Fund due to the reduced revenue being provided, and general funds reduced from the Healthy Start program being converted to Tobacco Settlement funds.

State of Hawaii
Department of Health

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2004

FINANCIAL ANALYSIS OF FUND FINANCIAL STATEMENTS

The following table presents revenues and expenditures of the governmental funds for 2004 and 2003 (\$000).

| | <u>2004</u> | <u>2003</u> (restated) |
|--|-----------------|---------------------------|
| Revenues | | |
| State general fund allotments | \$341,802 | \$317,485 |
| Nonimposed fringe benefits | 31,878 | 30,535 |
| Tobacco settlement funds | 38,490 | 43,524 |
| Intergovernmental funds | 95,758 | 84,624 |
| Taxes, fees, fines, and other | 17,480 | 16,887 |
| Investment income | <u>2,019</u> | <u>1,819</u> |
| Total revenues | 527,427 | 494,874 |
| Expenditures | | |
| General administration | 26,129 | 24,622 |
| Environmental health | 36,326 | 34,434 |
| Behavioral health | 205,778 | 190,608 |
| Health resources | <u>252,327</u> | <u>249,243</u> |
| Total expenditures | <u>520,560</u> | <u>498,907</u> |
| Excess revenues over expenditures before transfers | <u>\$ 6,867</u> | <u>\$ (4,033)</u> |

The governmental funds consist of the department's general fund, tobacco settlement funds, intergovernmental (federal) funds, and other sources of funds.

During the fiscal year ended June 30, 2004 general fund revenues were \$368.0 million, including \$31.8 million for fringe benefits paid directly from the State General Fund. General fund expenditures were \$372.8 million, including the \$31.8 million discussed above.

For 2004, the tobacco settlement fund received revenues of \$39.1 million, including investment income of \$0.6 million. \$34.9 million was expended of which \$4.5 million was for the Hawaii tobacco prevention and control trust fund, and \$10.1 million was for the University of Hawaii to assist in financing the construction of the medical school. In addition, \$8.8 million was transferred to the State Department of Budget and Finance.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2004

Approximately \$4.3 million was transferred from other governmental funds of which \$3.7 million was to the department's proprietary funds to meet the state matching requirements.

The proprietary funds consist of two funds: Water Pollution Control Revolving Fund and Drinking Water Treatment Revolving Loan Fund and are reported in the statement of net assets and statement of activities as business-type activities.

The Water Pollution Revolving Fund accounts for federal and state funds used to provide loans to county governments for the construction of wastewater treatment facilities and the repayment of principal, interest and fees from such loans and investment of such moneys. During 2004, this fund received \$0.4 million and \$2.1 million of federal and state funds, respectively. The fund also disbursed \$3.7 million loan proceeds and collected repayments of principal of \$10.7 million.

The Drinking Water Treatment Revolving Loan Fund accounts for federal and state funds used to provide loans and other types of financial assistance to public water systems for drinking water infrastructure and the repayment of principal interest and fees from such loans and the investment of such moneys. During 2004, this fund received \$2.1 million and \$1.6 million of federal and state funds, respectively. The fund disbursed \$2.9 million loan proceeds and collected repayment of principal of \$0.6 million.

The Department accounts for funds held as an agent and/or trustee for certain individuals in the fiduciary funds.

BUDGETARY ANALYSIS

The following budget information relates to the general fund and tobacco settlement fund for 2004.

| | Budgeted Amounts (\$000) | | Actual on a budgetary basis (\$000) |
|--------------------------|-----------------------------|-----------|---|
| | Original | Final | |
| General fund expenditure | | | |
| General administration | \$ 16,327 | \$ 16,326 | \$ 15,818 |
| Environmental health | 16,511 | 16,380 | 15,746 |
| Behavioral health | 172,599 | 173,190 | 169,468 |
| Health resources | 139,954 | 140,567 | 139,970 |
| Tobacco settlement fund | | | |
| Revenues | 50,342 | 50,342 | 39,092 |
| Expenditures | 50,342 | 50,342 | 42,103 |

State of Hawaii
Department of Health

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2004

The differences between the original and final budget for the general fund was primarily due to the the delay in hiring on vacant positions of many programs throughout the department. Other differences occurred due to contracts being delayed, and lower than expected caseloads for services. The actual expenditures on a budgetary basis for the general fund were \$ 4.3_ million less than the budgeted expenditures.

There no differences between the original and final budget for the tobacco settlement fund. The amount of funds collected, \$39.1 million, was \$11.2 million less than the final budgeted amount. The shortfall in revenues collected as compared to amounts budgeted is due to the fact that amounts ultimately paid to the state are based on a complex formula of which the primary determinants are not estimable. The amount expended on a budgetary basis, 42.1 million, was \$1.8 million less than the final budgeted amount. This was primarily due to variances in program capabilities and operating needs.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

As of June 30, 2004, the Department had invested approximately \$70.2 million (net of accumulated depreciation) in a broad range of capital assets. This amount represents a decrease of about \$3.1 million. The decrease is primarily related to depreciation expense which approximated \$5 million. See Note D to the Department's financial statements for a description of capital assets activities for the fiscal year ended June 30, 2004.

Capital Assets
Governmental Activities
June 30,
(\$000)

| | 2004 | 2003 (restated) |
|--------------------------------|------------------|--------------------|
| Land | \$ 1,018 | \$ 1,018 |
| Land and building improvements | 127,700 | 127,700 |
| Furniture and equipment | 14,273 | 12,792 |
| Total | 142,991 | 141,510 |
| Accumulated depreciation | 72,816 | 68,269 |
| Total capital assets, net | <u>\$ 70,175</u> | <u>\$ 73,241</u> |

State of Hawaii
Department of Health

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2004

At June 30, 2004, the Department's noncurrent debt relates to the noncurrent portion of accrued vacation (see Note A).

RESTATEMENT OF 2003 FINANCIAL INFORMATION

The financial information for 2003 has been restated to reflect the reporting of fringe benefits on accrued vacation as of June 30, 2003 (see Note I).

CURRENTLY KNOWN FACTS, DECISIONS, OR CONDITIONS

The Department will continue to place its efforts on the mental health and substance abuse health priorities of the state. The Adult Mental Health Division will work diligently to address the requirements of the Community Plan for out-patients to move toward the dismissal of the Department of Justice's continuing oversight of this Plan. We have been successful in providing significant advancements in the treatment and care of our patients which resulted in the December 2004 court dismissal of the 13-year old Department of Justice lawsuit against the Hawaii State Hospital. In line with maintaining and improving our mental health services are our priority efforts to advance the administration's substance abuse (ice, alcohol, and drug) initiative. Similar high level efforts will continue to address the court mandates of the Makin Settlement requiring services for the developmentally disabled, and the Felix Consent Decree for children and youth with special needs. Significant financial resources will continue to be expended in these areas to meet the required objectives.

Significant financial impact is anticipated with the continued implementation of the Beverage Container Deposit program which started in October 2004 with retailers collecting fees and deposits (\$.01 and \$.05 per container, respectively) with the sale of certain beverage containers. The full implementation of this program is progressing, with a substantial level of fees and deposits being collected in a new special fund to be expended for costs of providing the program as well as payment back to consumers (deposits) for the recycling of these containers.

State of Hawaii
Department of Health

STATEMENT OF NET ASSETS

June 30, 2004

| ASSETS | Primary Government | | |
|--|----------------------------|-----------------------------|-----------------------|
| | Governmental Activities | Business-type Activities | Total |
| CURRENT ASSETS | | | |
| Cash and cash equivalents on deposit with the State of Hawaii | \$ 117,755,025 | \$ 118,002,123 | \$ 235,757,148 |
| Receivables | | | |
| Accrued interest and loan fee | 80,197 | 2,188,787 | 2,268,984 |
| Due from Federal government | 4,006,038 | 1,213,268 | 5,219,306 |
| Internal balances | (220,000) | 220,000 | - |
| Current maturities of loans receivables (note C) | - | 11,766,983 | 11,766,983 |
| | <u>3,866,235</u> | <u>15,389,038</u> | <u>19,255,273</u> |
| Total current assets | 121,621,260 | 133,391,161 | 255,012,421 |
| LOANS RECEIVABLE, net of current maturities (note C) | - | 157,283,363 | 157,283,363 |
| CAPITAL ASSETS (net of accumulated depreciation) (notes A6 and D) | <u>69,907,030</u> | <u>267,566</u> | <u>70,174,596</u> |
| TOTAL ASSETS | <u>\$ 191,528,290</u> | <u>\$ 290,942,090</u> | <u>\$ 482,470,380</u> |
| LIABILITIES AND NET ASSETS | | | |
| CURRENT LIABILITIES | | | |
| Vouchers and contracts payable | \$ 15,862,772 | \$ - | \$ 15,862,772 |
| Accrued wages and employee benefits payable | 7,225,084 | 54,513 | 7,279,597 |
| Accrued vacation, current portion (note A9) | 7,419,395 | - | 7,419,395 |
| Workers' compensation liability | 622,617 | - | 622,617 |
| Deferred income | 341,428 | - | 341,428 |
| Due to other funds | <u>42,750</u> | <u>-</u> | <u>42,750</u> |
| Total current liabilities | 31,514,046 | 54,513 | 31,568,559 |
| ACCRUED VACATION, net of current portion (note A9) | 14,622,776 | - | 14,622,776 |
| COMMITMENTS AND CONTINGENCIES (notes F and G) | - | - | - |
| NET ASSETS | | | |
| Investment in capital assets | 69,907,030 | 267,566 | 70,174,596 |
| Restricted for: | | | |
| Loans | - | 290,620,011 | 290,620,011 |
| Tobacco prevention and control | 22,706,051 | - | 22,706,051 |
| Capital projects | 2,439,895 | - | 2,439,895 |
| Other purposes | 33,525,140 | - | 33,525,140 |
| Unrestricted | <u>16,813,352</u> | <u>-</u> | <u>16,813,352</u> |
| | <u>145,391,468</u> | <u>290,887,577</u> | <u>436,279,045</u> |
| TOTAL LIABILITIES AND NET ASSETS | <u>\$ 191,528,290</u> | <u>\$ 290,942,090</u> | <u>\$ 482,470,380</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

STATEMENT OF ACTIVITIES

Year ended June 30, 2004

| Functions/Programs | Expenses | Program revenues | | Net (expense) revenue and changes in net assets | | |
|--|-----------------------|-------------------------|--|---|-----------------------------|-----------------------|
| | | Charges for Services | Operating Grants and Contributions | Primary Government | | |
| | | | | Governmental Activities | Business-type Activities | Total |
| Primary government | | | | | | |
| Governmental Activities | | | | | | |
| General administration | \$ 26,434,226 | \$ 427,819 | \$ 8,289,153 | \$ (17,717,254) | \$ - | \$ (17,717,254) |
| Environmental health administration | 38,350,278 | 3,849,756 | 9,607,980 | (24,892,542) | - | (24,892,542) |
| Behavioral health services administration | 206,441,473 | 2,868,335 | 15,195,686 | (188,377,452) | - | (188,377,452) |
| Health resources administration | 252,700,222 | 2,109,423 | 64,732,406 | (185,858,393) | - | (185,858,393) |
| Total governmental activities | 523,926,199 | 9,255,333 | 97,825,225 | (416,845,641) | - | (416,845,641) |
| Business-type activities | | | | | | |
| Environmental health loan programs | 2,160,206 | 6,068,186 | 5,589,725 | - | 9,497,705 | 9,497,705 |
| Total business-type activities | 2,160,206 | 6,068,186 | 5,589,725 | - | 9,497,705 | 9,497,705 |
| Total primary government | <u>\$ 526,086,405</u> | <u>\$ 15,323,519</u> | <u>\$ 103,414,950</u> | (416,845,641) | 9,497,705 | (407,347,936) |
| General revenues | | | | | | |
| State general fund allotments | | | | 341,801,761 | - | 341,801,761 |
| Nonimposed employee fringe benefits | | | | 31,877,725 | - | 31,877,725 |
| Environmental response tax | | | | 1,627,658 | - | 1,627,658 |
| Deposit beverage container fee | | | | 3,746,175 | - | 3,746,175 |
| Advance glass disposal fee | | | | 2,757,444 | - | 2,757,444 |
| Tobacco settlement funds | | | | 38,489,601 | - | 38,489,601 |
| Transfers | | | | (13,045,034) | 3,697,000 | (9,348,034) |
| Total general revenues and transfers | | | | 407,255,330 | 3,697,000 | 410,952,330 |
| Change in net assets | | | | (9,590,311) | 13,194,705 | 3,604,394 |
| Net assets at July 1, 2003, as restated (note I) | | | | 154,981,779 | 277,692,872 | 432,674,651 |
| Net assets at June 30, 2004 | | | | <u>\$ 145,391,468</u> | <u>\$ 290,887,577</u> | <u>\$ 436,279,045</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

GOVERNMENTAL FUNDS
BALANCE SHEET

June 30, 2004

| ASSETS | General | Tobacco Settlement | Other Funds | Total Governmental |
|--|----------------------|-----------------------|----------------------|-----------------------|
| Cash and cash equivalents | \$ 45,179,510 | \$ 23,838,407 | \$ 48,737,108 | \$ 117,755,025 |
| Accrued interest receivable | - | - | 80,197 | 80,197 |
| Due from Federal government | - | - | 4,006,038 | 4,006,038 |
| TOTAL ASSETS | \$ 45,179,510 | \$ 23,838,407 | \$ 52,823,343 | \$ 121,841,260 |
| LIABILITIES AND FUND BALANCES | | | | |
| Liabilities | | | | |
| Vouchers and contracts payable | \$ 9,015,030 | \$ 1,083,086 | \$ 5,764,656 | \$ 15,862,772 |
| Accrued wages and employee benefits | 5,474,722 | 49,271 | 1,701,091 | 7,225,084 |
| Deferred income | - | - | 341,428 | 341,428 |
| Due to State of Hawaii | 42,750 | - | - | 42,750 |
| Due to other funds | - | - | 220,000 | 220,000 |
| Total liabilities | 14,532,502 | 1,132,357 | 8,027,175 | 23,692,034 |
| Fund Balances | | | | |
| Reserved for encumbrance | 34,814,634 | 7,031,134 | 27,837,315 | 69,683,083 |
| Unreserved, reported in: | | | | |
| General fund | (4,167,626) | - | - | (4,167,626) |
| Tobacco settlement fund | - | 15,674,916 | - | 15,674,916 |
| Special revenue funds | - | - | 16,958,853 | 16,958,853 |
| Total fund balances | 30,647,008 | 22,706,050 | 44,796,168 | 98,149,226 |
| TOTAL LIABILITIES AND FUND BALANCES | \$ 45,179,510 | \$ 23,838,407 | \$ 52,823,343 | \$ 121,841,260 |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

RECONCILIATION OF THE GOVERNMENTAL FUND BALANCE TO THE
STATEMENT OF NET ASSETS

June 30, 2004

| | |
|---|------------------------------|
| Total fund balance - governmental funds | \$ 98,149,226 |
| Amounts reported for governmental activities in the statement of net assets are different because: | |
| Capital assets used in governmental activities are not financial resources and therefore not reported in the funds. | 69,907,030 |
| Compensated absences reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds. | (22,042,171) |
| Workers' compensation liability reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds. | <u>(622,617)</u> |
| Net assets of governmental activities | <u><u>\$ 145,391,468</u></u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

Year ended June 30, 2004

| | General | Tobacco Settlement | Other Funds | Total Governmental |
|---|----------------|-----------------------|---------------|-----------------------|
| Revenues | | | | |
| State allotments, net | \$ 336,170,867 | \$ - | \$ 5,630,894 | \$ 341,801,761 |
| Intergovernmental | - | - | 95,757,822 | 95,757,822 |
| Tobacco settlement | - | 38,489,601 | - | 38,489,601 |
| Non-imposed employee fringe benefits | 31,877,725 | - | - | 31,877,725 |
| Taxes, fees, fines and other | - | - | 17,480,238 | 17,480,238 |
| Interest income | - | 621,778 | 1,397,585 | 2,019,363 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total revenues | 368,048,592 | 39,111,379 | 120,266,539 | 527,426,510 |
| Expenditures | | | | |
| General administration | 17,948,020 | - | 8,181,043 | 26,129,063 |
| Environmental health | 19,450,719 | - | 16,875,227 | 36,325,946 |
| Behavioral health services | 186,770,647 | - | 19,007,005 | 205,777,652 |
| Health resources | 148,649,857 | 34,856,317 | 68,820,997 | 252,327,171 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total expenditures | 372,819,243 | 34,856,317 | 112,884,272 | 520,559,832 |
| Excess (deficiency) of revenues over expenditures | (4,770,651) | 4,255,062 | 7,382,267 | 6,866,678 |
| Other financing sources (uses) | | | | |
| Transfers in | - | - | 100,000 | 100,000 |
| Transfers out | - | (8,826,064) | (4,318,970) | (13,145,034) |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total other financing uses | - | (8,826,064) | (4,218,970) | (13,045,034) |
| Net change in fund balances | (4,770,651) | (4,571,002) | 3,163,297 | (6,178,356) |
| Fund Balances at July 1, 2003 | 35,417,659 | 27,277,052 | 41,632,871 | 104,327,582 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Fund Balances at June 30, 2004 | \$ 30,647,008 | \$ 22,706,050 | \$ 44,796,168 | \$ 98,149,226 |
| | <hr/> | <hr/> | <hr/> | <hr/> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES

Year ended June 30, 2004

Net change in fund balances - total governmental funds \$ (6,178,356)

Amounts reported for governmental activities in the statement of activities
are different because:

Governmental funds report capital outlays as expenditures. However
in the statement of activities the cost of those assets is allocated
over their estimated useful lives and reported as depreciation expense.
This is the amount by which depreciation exceeded capital outlays
for the year. (2,982,666)

Compensated absences reported in the statement of activities
do not require the use of current financial resources and therefore are
not reported as expenditures in governmental funds. (441,045)

Workers' compensation liability reported in the statement of activities
do not require the use of current financial resources and therefore are
not reported as expenditures in governmental funds. 11,756

Change in net assets of governmental activities \$ (9,590,311)

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

STATEMENT OF NET ASSETS – PROPRIETARY FUNDS

June 30, 2004

| | Water Pollution Control Revolving Fund | Drinking Water Treatment Revolving Loan Fund | Total |
|---|--|---|-----------------------------|
| | <u> </u> | <u> </u> | <u> </u> |
| ASSETS | | | |
| Current assets | | | |
| Cash and cash equivalents | | | |
| in State Treasury | \$ 105,894,017 | \$ 12,108,106 | \$ 118,002,123 |
| Loan fees receivable | 551,283 | 104,785 | 656,068 |
| Accrued interest receivable | 1,487,703 | 45,016 | 1,532,719 |
| Due from other funds | - | 220,000 | 220,000 |
| Due from federal government | 3,321 | 1,209,947 | 1,213,268 |
| Current portion of loans receivable | 11,036,852 | 730,131 | 11,766,983 |
| | <u> </u> | <u> </u> | <u> </u> |
| Total current assets | 118,973,176 | 14,417,985 | 133,391,161 |
| Loans receivable, net of current portion | 144,414,446 | 12,868,917 | 157,283,363 |
| Property and equipment, net of accumulated depreciation, at cost | 8,667 | 258,899 | 267,566 |
| | <u> </u> | <u> </u> | <u> </u> |
| TOTAL ASSETS | <u>\$ 263,396,289</u> | <u>\$ 27,545,801</u> | <u>\$ 290,942,090</u> |
| LIABILITIES | | | |
| Current liabilities | | | |
| Accrued payroll and other | \$ 41,690 | \$ 12,823 | \$ 54,513 |
| | <u> </u> | <u> </u> | <u> </u> |
| Total liabilities | 41,690 | 12,823 | 54,513 |
| NET ASSETS | | | |
| Invested in capital assets | 8,667 | 258,899 | 267,566 |
| Restricted | 263,345,932 | 27,274,079 | 290,620,011 |
| | <u> </u> | <u> </u> | <u> </u> |
| Total net assets | 263,354,599 | 27,532,978 | 290,887,577 |
| | <u> </u> | <u> </u> | <u> </u> |
| TOTAL LIABILITIES AND NET ASSETS | <u>\$ 263,396,289</u> | <u>\$ 27,545,801</u> | <u>\$ 290,942,090</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS –
PROPRIETARY FUND

Year ended June 30, 2004

| | Water Pollution Control Revolving Fund | Drinking Water Treatment Revolving Loan Fund | Total |
|----------------------------------|---|---|-----------------------|
| Operating revenues | | | |
| Interest income from loans | \$ 3,944,315 | \$ 176,833 | \$ 4,121,148 |
| Administration loan fee | 1,529,192 | 417,846 | 1,947,038 |
| | <u>5,473,507</u> | <u>594,679</u> | <u>6,068,186</u> |
| Total revenues | | | |
| Expenses | | | |
| Administrative | 1,184,923 | 310,135 | 1,495,058 |
| State program management | - | 324,853 | 324,853 |
| Water protection | - | 340,295 | 340,295 |
| | <u>1,184,923</u> | <u>975,283</u> | <u>2,160,206</u> |
| Total expenses | | | |
| Operating income | 4,288,584 | (380,604) | 3,907,980 |
| Nonoperating revenues | | | |
| Federal contributions | 7,682 | 2,860,198 | 2,867,880 |
| Interest income from investments | 2,454,071 | 267,654 | 2,721,725 |
| Other | - | 120 | 120 |
| | <u>2,461,753</u> | <u>3,127,972</u> | <u>5,589,725</u> |
| Total nonoperating revenues | | | |
| Income before transfers | 6,750,337 | 2,747,368 | 9,497,705 |
| Transfers in | 2,086,000 | 1,611,000 | 3,697,000 |
| | <u>8,836,337</u> | <u>4,358,368</u> | <u>13,194,705</u> |
| CHANGE IN NET ASSETS | | | |
| Net assets at July 1, 2003 | 254,518,262 | 23,174,610 | 277,692,872 |
| Net assets at June 30, 2004 | <u>\$ 263,354,599</u> | <u>\$ 27,532,978</u> | <u>\$ 290,887,577</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

STATEMENT OF CASH FLOWS – PROPRIETARY FUND

Year ended June 30, 2004

| | Water Pollution Control Revolving Fund | Drinking Water Treatment Revolving Loan Fund | Total |
|--|---|---|-----------------------|
| Cash flows from operating activities: | | | |
| Interest income from loans | \$ 4,073,082 | \$ 169,015 | \$ 4,242,097 |
| Administrative loan fees | 1,544,453 | 387,091 | 1,931,544 |
| Principal repayments on loans | 10,751,882 | 619,755 | 11,371,637 |
| Disbursement of loan proceeds | (3,747,894) | (2,994,527) | (6,742,421) |
| Payment to employees | (1,053,197) | (297,435) | (1,350,632) |
| Payments to vendors | (120,086) | (569,130) | (689,216) |
| | | | |
| Net cash flows provided by (used in) operating activities | 11,448,240 | (2,685,231) | 8,763,009 |
| Cash flows from noncapital financing activities: | | | |
| Federal contributions | 404,437 | 2,101,606 | 2,506,043 |
| State contributions | 2,086,000 | 1,611,000 | 3,697,000 |
| Transfer from other funds | - | 175,000 | 175,000 |
| | | | |
| Net cash flows provided by noncapital financing activities | 2,490,437 | 3,887,606 | 6,378,043 |
| Cash flows from capital and related financing activities: | | | |
| Purchase of equipment | - | (30,825) | (30,825) |
| | | | |
| Net cash flows used in capital and related financing activities | - | (30,825) | (30,825) |
| Cash flows from investing activities: | | | |
| Interest from investments | 2,426,350 | 262,821 | 2,689,171 |
| | | | |
| Net cash flows provided by investing activities | 2,426,350 | 262,821 | 2,689,171 |
| | | | |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 16,365,027 | 1,434,371 | 17,799,398 |
| Cash and cash equivalents at July 1, 2003 | 89,528,990 | 10,673,735 | 100,202,725 |
| Cash and cash equivalents at June 30, 2004 | <u>\$ 105,894,017</u> | <u>\$ 12,108,106</u> | <u>\$ 118,002,123</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

STATEMENT OF CASH FLOWS – PROPRIETARY FUND (continued)

Year ended June 30, 2004

| | Water Pollution Control Revolving Fund | Drinking Water Treatment Revolving Loan Fund | Total |
|---|---|---|-----------------------------|
| | <u> </u> | <u> </u> | <u> </u> |
| Reconciliation of operating income to net cash provided by (used in) operating activities: | | | |
| Operating income | \$ 4,288,584 | \$ (380,604) | \$ 3,907,980 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | | |
| Depreciation expense | 11,294 | 103,514 | 114,808 |
| Change in assets and liabilities: | | | |
| Loan receivables | 7,003,988 | (2,374,772) | 4,629,216 |
| Accrued interest on loans receivables | 128,766 | (7,818) | 120,948 |
| Loan fees receivable | 15,261 | (30,755) | (15,494) |
| Accrued wages and other | 347 | 5,204 | 5,551 |
| | <u> </u> | <u> </u> | <u> </u> |
| Net cash provided by (used in) operating activities | <u><u>\$ 11,448,240</u></u> | <u><u>\$ (2,685,231)</u></u> | <u><u>\$ 8,763,009</u></u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUNDS

June 30, 2004

| ASSETS | Agency funds |
|-----------------------------------|--------------------------|
| Cash and cash equivalents | |
| On deposit with banks and on hand | <u>\$ 334,359</u> |
| TOTAL ASSETS | <u><u>\$ 334,359</u></u> |
| LIABILITIES | |
| Due to others | <u>\$ 334,359</u> |
| TOTAL LIABILITIES | <u><u>\$ 334,359</u></u> |
| Net assets | <u><u>\$ -</u></u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Introduction

The Department of Health (Department), State of Hawaii (State), administers and oversees statewide personal health services, health promotion and disease prevention, mental health programs, monitoring of the environment and the enforcement of environmental health laws. Federal grants received to support the State's health services and programs are administered by the Department.

The accompanying financial statements of the Department have been prepared in conformity with accounting principles generally accepted in the United States of America prescribed by the Governmental Accounting Standards Board (GASB).

The Department is part of the executive branch of the State. The financial statements of the Department of Health, State of Hawaii, are intended to present the financial position and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2004, and the changes in its financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

2. Reporting Entity

The Department has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Department are such that exclusion would cause the Department's financial statements to be misleading or incomplete. GASB has set forth criteria to be considered in determining financial accountability. The Department has determined, based on the GASB criteria, that it has no component units.

3. Government-Wide and Fund Financial Statements

The government-wide financial statements, the statement of net assets and the statement of activities, report information of all of the nonfiduciary activities of the Department. Governmental activities, which normally are supported by State allotments and intergovernmental

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3. Government-Wide and Fund Financial Statements (continued)

revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use, or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. State allotments and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

Net assets are restricted when constraints placed on them are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, generally it is the Department's policy to use restricted resources first, then unrestricted resources as they are needed.

Separate financial statements are provided for governmental funds, proprietary funds and fiduciary funds. However, the fiduciary funds are not included in the government-wide statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

4. Measurement Focus, Basis of Accounting and Financial Statement Presentation

Government-wide financial statements – The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Department considers

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. Measurement Focus, Basis of Accounting and Financial Statement Presentation (continued)

revenues to be available if they are collected within 60 days of the end of the current fiscal year end. Principal revenue sources considered susceptible to accrual include federal grants and interest on investments. Some revenue items that are considered measurable and available to finance operations during the year from an accounting perspective are not available for expenditure due to the State's present appropriation system. These revenues have been accrued in accordance with generally accepted accounting principles since they have been earned and are expected to be collected within sixty days of the end of the period. Other revenues are considered to be measurable and available only when cash is received by the Department.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include employees' vested vacation which is recorded as an expenditure when utilized or paid (note A9).

Proprietary Funds and Fiduciary Funds – The financial statements of proprietary funds and fiduciary funds are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide statements described above.

The Department has the option under GASB Statement 20, Accounting and Financial Reporting for Proprietary funds and Other Governmental Entities that Use Proprietary Fund Accounting, to elect to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The Department's two enterprise funds have elected not to apply FASB statements after the applicable date.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services or goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal operating revenues of the Department's enterprise funds are interest income and administrative loan fees on loans made to county governments. Federal grants and interest income from investments are reported as nonoperating income and State matching funds are reported as transfers in.

5. Fund Accounting

The financial activities of the Department are recorded in individual funds, each of which is deemed to be a separate accounting entity. The Department uses fund accounting to report on its financial position and results of operations. Fund accounting is designed to demonstrate the legal

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

5. Fund Accounting (continued)

compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

a. Governmental funds

General fund – The general fund is the general operating fund of the Department. It is used to account for all financial activities except those required to be accounted for in another fund. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted.

Special revenue funds – Special revenue funds are used to account for the proceeds of specific revenue sources (other than major capital projects) that are legally restricted to expenditures for specified purposes.

Capital projects fund – Capital projects funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary fund type).

b. Proprietary funds

These funds account for those activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to customers, or where sound financial management dictates that periodic determinations of results of operations are appropriate.

c. Fiduciary funds

The Department presents as fiduciary funds those activities that account for assets held in a trustee capacity or as an agent for individuals, private organizations, or other governmental units.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

5. Fund Accounting (continued)

d. Major funds

The Department reports the following major governmental funds:

General Fund

Hawaii Tobacco Settlement Special Fund – accounts for all tobacco settlement monies and interest and earnings accruing from the investment of such monies.

The Department reports the following major proprietary funds:

Water Pollution Control Revolving Fund – accounts for federal and state funds used to provide loans in perpetuity to county and state agencies for the construction of wastewater treatment facilities and the repayment, interest and earnings from such loans and the investment of such monies.

Drinking Water Treatment Revolving Loan Fund – accounts for federal and state funds used to provide loans and other types of financial assistance to public water systems for drinking water infrastructure and the repayment, interest and earnings from such loans and the investment of such monies.

6. Capital Assets

Capital assets, which include property and equipment, are reported in the applicable governmental or business-type activities in the government-wide financial statements and in the proprietary fund financial statements. Capital assets are defined by the Department as those assets with estimated useful lives greater than one year and with an acquisition cost greater than:

| | |
|------------------------------------|-----------------|
| Land | All capitalized |
| Land improvements | \$100,000 |
| Building and building improvements | 100,000 |
| Equipment | 5,000 |

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

6. Capital Assets (continued)

Purchased and constructed capital assets are valued at cost. Donated assets are recorded at their fair market value at the date of donation.

Capital assets utilized in the governmental funds are recorded as expenditures when incurred in the governmental fund financial statements.

Depreciation expense is recorded in the government-wide financial statements, as well as the proprietary funds financial statements. The Department utilizes the straight-line method over the assets' estimated useful life. No depreciation is recorded for land. Generally, the useful lives are as follows:

| | <u>Governmental- type activities</u> | <u>Proprietary fund and business- type activities</u> |
|------------------------------------|--|---|
| Land improvements | 15 | Not applicable |
| Building and building improvements | 30 | Not applicable |
| Furniture and equipment | 5 – 7 | 5 – 7 |

7. Cash and Cash Equivalents

Cash and cash equivalents include short-term investments with original maturities of three months or less. It also includes amounts held in the State Treasury. The State Director of Finance is responsible for safekeeping of all monies paid into the State Treasury (cash pool). The Director of Finance may invest any monies of the State, which in the Director's judgment are in excess of the amounts necessary for meeting the immediate requirements of the State. Cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or participates in the State Treasury Investment Pool System. Cash accounts that participate in the investment pool accrue interest based on the average weighted cash balances of each account.

The State requires that the depository banks pledge, as collateral, government securities held in the name of the State for deposits not covered by federal deposit insurance.

Investments can be categorized to give an indication of the level of risk assumed by the Department. Category 1 includes investments that are insured or for repurchase agreements,

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

7. Cash and Cash Equivalents (continued)

collateralized by underlying securities that are so held. Category 2 includes uninsured and unregistered investments for which the securities are held by the broker-dealer in the Department's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker-dealer but not in the Department's name.

Since all of the Department's cash is included in the State cash pool, the category of risk is not determinable at the Department level.

8. Deferred Revenues

Deferred revenues at the fund level and government-wide level arise when the Department receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criteria is met, or when the Department has a legal claim to the resources, the liability for deferred revenue is removed from the statement of net assets and balance sheet, and revenue is recognized. Deferred revenues at June 30, 2004 consists primarily of Federal grant funds for which all eligibility requirements have not been met.

9. Compensated Absences

Employees hired on or before July 1, 2001 earn vacation at the rate of one and three-quarters working days for each month of service. Employees hired after July 1, 2001 earn vacation at rates ranging between 1 and 2 working days for each month of service, depending upon the employee's years of service and job classification. Vacation days may be accumulated to a maximum of 90 days. Employees are entitled to receive cash payment for accumulated vacation upon termination. Accumulated vacation is not reported in the governmental fund financial statements as that amount is not expected to be paid with current funds. The government-wide financial statements present the cost of accumulated unpaid vacation as a liability. A reconciliation of changes in aggregate liabilities for accumulated vacation is as follows:

| | |
|--------------------------|----------------------------|
| Balance at July 1, 2003 | \$21,601,124 |
| Additions | 9,265,969 |
| Deletions | <u>(8,824,922)</u> |
| Balance at June 30, 2004 | 22,042,171 |
| Less current portion | <u>7,419,395</u> |
| | <u><u>\$14,622,776</u></u> |

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

9. Compensated Absences (continued)

Employees hired on or before July 1, 2001 also earn sick leave credits at the rate of one and three-quarters working days for each month of service. Employees hired after July 1, 2001 earn sick leave credits at the rate of one and one-quarter or one and three-quarters working days for each month of service, depending upon the employee's years of service and job classification. Sick leave credits may be accumulated without limit. Sick leave can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for unpaid sick leave credits is reported in the accompanying financial statements. However, a Department employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System of the State of Hawaii. Accumulated sick leave as of June 30, 2004 relating to the Department approximated \$57,949,192.

10. Insurance

Insurance coverage is maintained at the State level. The State is substantially self-insured for all perils including workers' compensation. Expenditures for workers' compensation and other insurance claims are appropriated annually from the State General Fund.

Under the provisions of GASB Statement No. 10, liabilities related to certain types of losses (including torts, theft of, damage to, or destruction of assets, errors or omissions, natural disasters and injuries to employees), are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

During the year ended June 30, 2004, the Department was covered by the State's self-insured workers' compensation program for medical expenses of the injured Department employees. However, the Department was required to pay Temporary Total Disability (TTD) and Temporary Partial Disability (TPD) benefits for employees on the Department's payroll. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

10. Insurance (continued)

A reconciliation of changes in workers' compensation liability is as follows:

| | |
|--------------------------|-------------------|
| Balance at July 1, 2003 | \$ 634,373 |
| Additions | 651,261 |
| Deletions | <u>(663,017)</u> |
| Balance at June 30, 2004 | <u>\$ 622,617</u> |

11. Transfers

Transfers are used to move revenues from the fund that statute requires to collect them to the fund that statute requires to expend them. The government-wide statement of activities eliminates transfers within the segregated governmental and business-type activities. Only transfers between the two columns appear in this statement.

12. Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

13. Non-imposed Employee Fringe Benefits

Payroll fringe benefit costs of the Department's employees funded by general fund appropriations are assumed by the State and are not charged to the Department's operating funds. These costs, totaling \$31,877,725, of which \$7,604,738 was for retirement benefits, have been reported as revenues and expenditures in the Department's financial statements for the fiscal year ended June 30, 2004.

Payroll fringe benefit costs related to federally funded salaries are not assumed by the State and are recorded as expenditures in the Department's financial statements.

NOTE B – BUDGETING AND BUDGETARY CONTROL

Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated throughout the fiscal year. Budgeted expenditures are derived primarily from acts of the State Legislature and from other authorizations contained in the State Constitution, the Hawaii

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE B – BUDGETING AND BUDGETARY CONTROL (continued)

Revised Statutes and other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii. To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the year for which the appropriations were made. The State Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations.

For purposes of budgeting, the Department's budgetary fund structure and accounting principles differ from those utilized to present the financial statements in conformity with accounting principles generally accepted in the United States of America (US GAAP). Encumbrances represent executed but unperformed purchase orders or contracts. In the accompanying financial statements, encumbrances are recorded as expenditures for budgetary purposes and as reservations of fund balance for GAAP purposes. Since budgetary basis differs from GAAP, budget and actual amounts in the accompanying Required Supplementary Information – Budgetary Schedules are presented on the budgetary basis. A reconciliation of revenues in excess of (less than) expenditures and other financing sources (uses) on a budgetary basis at June 30, 2004, to revenues in excess of (less than) expenditures and other financing sources (uses) presented in conformity with GAAP is set forth in the Notes to the Required Supplementary Information.

NOTE C – LOANS RECEIVABLE

At June 30, 2004, the proprietary fund loans receivable consists of loans to county governmental units for the water pollution control and drinking water treatment programs. The loans are due in annual, semi-annual or quarterly payments, including interest at 1.55% to 3.02%, commencing not later than one year after project completion or notice to proceed. Final payment is due not later than twenty years after project completion. Accrued interest receivable on the loans amounted to approximately \$1,434,878 at June 30, 2004.

The following is a schedule of principal payments due on loans for projects completed or in progress as of June 30, 2004:

| Year ending June 30, | |
|----------------------|-----------------------------|
| 2005 | \$ 11,766,983 |
| 2006 | 12,051,307 |
| 2007 | 12,346,076 |
| 2008 | 12,693,416 |
| 2009 | 12,961,603 |
| Thereafter | <u>107,230,961</u> |
| | <u><u>\$169,050,346</u></u> |

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE D – CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2004 was as follows:

| | <u>Beginning balance</u> | <u>Additions</u> | <u>Dispositions</u> | <u>Ending balance</u> |
|--|--------------------------|----------------------|---------------------|-----------------------|
| Governmental activities: | | | | |
| Capital assets, not being depreciated | | | | |
| Land | <u>\$ 1,018,080</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 1,018,080</u> |
| Total capital assets not being depreciated | 1,018,080 | — | — | 1,018,080 |
| Capital assets, being depreciated | | | | |
| Land improvements | 1,862,927 | — | — | 1,862,927 |
| Building and improvements | 125,837,479 | — | — | 125,837,479 |
| Furniture and equipment | <u>12,198,508</u> | <u>2,131,854</u> | <u>(614,159)</u> | <u>13,716,203</u> |
| Total capital assets being depreciated | 139,898,914 | 2,131,854 | (614,159) | 141,416,609 |
| Less accumulated depreciation | | | | |
| Land improvements | 1,590,778 | 115,025 | — | 1,705,803 |
| Building and improvements | 56,335,184 | 3,892,469 | — | 60,227,653 |
| Furniture and equipment | <u>10,101,336</u> | <u>915,511</u> | <u>(422,644)</u> | <u>10,594,203</u> |
| Total accumulated depreciation | <u>68,027,298</u> | <u>4,923,005</u> | <u>(422,644)</u> | <u>72,527,659</u> |
| Governmental activities, net | <u>\$ 72,889,696</u> | <u>\$(2,791,151)</u> | <u>\$ (191,515)</u> | <u>\$ 69,907,030</u> |
| Business-type activities: | | | | |
| Capital assets being depreciated | | | | |
| Equipment | <u>\$ 593,462</u> | <u>\$ 30,825</u> | <u>\$ (67,596)</u> | <u>\$ 556,691</u> |
| Total capital assets being depreciated | 593,462 | 30,825 | (67,596) | 556,691 |
| Less accumulated depreciation for: | | | | |
| Equipment | <u>241,913</u> | <u>114,808</u> | <u>(67,596)</u> | <u>289,125</u> |
| Total accumulated depreciation | <u>241,913</u> | <u>114,808</u> | <u>(67,596)</u> | <u>289,125</u> |
| Business-type activities capital assets, net | <u>\$ 351,549</u> | <u>\$ (83,983)</u> | <u>\$ —</u> | <u>\$ 267,566</u> |

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE D – CAPITAL ASSETS (continued)

Current period depreciation expense was charged to function as follows:

| | |
|---|---------------------------|
| Governmental activities: | |
| General administration | \$ 470,189 |
| Environmental health | 1,424,603 |
| Behavioral health | 1,777,914 |
| Health resources | <u>1,250,299</u> |
| Total depreciation expense – governmental activities | <u><u>\$4,923,005</u></u> |
| Business-type activities: | |
| Environmental health | <u>\$ 114,808</u> |
| Total depreciation expense – business-type activities | <u><u>\$ 114,808</u></u> |

NOTE E – RETIREMENT BENEFITS

1. Employees' Retirement System

Plan Description

All eligible employees of the State are required by Chapter 88 of the Hawaii Revised Statutes to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS is governed by a Board of Trustees. All contributions, benefits and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. The ERS issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information for ERS. That report may be obtained by writing to the ERS, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

The ERS consists of a contributory plan and a noncontributory plan. Employees covered by Social Security on June 30, 1984 were given the option of joining the noncontributory plan or remaining in the contributory plan. All new employees hired after June 30, 1984, who are covered by Social Security, are generally required to join the noncontributory plan. Both plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the payment of salary in lieu of vacation, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after this date is based on the three highest

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE E – RETIREMENT BENEFITS (continued)

1. Employees' Retirement System (continued)

Plan Description (continued)

paid years of service excluding the payment of salary in lieu of vacation. Vesting requirements for the contributory and noncontributory plans are five years and ten years, respectively. All contributions, benefits and eligibility requirements are governed by Chapter 88.

Funding Policy

Most covered employees of the contributory plan are required to contribute 7.8% of their salary. Police officers, firefighters, investigators of the department of the prosecuting attorney and the attorney general, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2% of their salary. The actuarial cost or funding method used to calculate the total employer contribution required is the entry age normal actuarial cost method. Under this method, the total employer contributions to the ERS is comprised of normal cost plus level annual payments required to amortize the unfunded actuarial accrued liability over the closed period ending June 30, 2029.

The contribution requirement for all employers as of June 30, 2004 was approximately \$236 million (100% contributed).

2. Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State, pursuant to HRS Chapter 87, provides certain health care and life insurance benefits to all qualified employees.

For employees hired before July 1, 1996, the State pays the entire monthly health care premium for employees retiring with ten or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than ten years of credited service.

For employees hired after June 30, 1996, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium; for those retiring with over 25 years of service, the State pays the entire health care premium.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE E – RETIREMENT BENEFITS (continued)

2. Post-Retirement Health Care and Life Insurance Benefits (continued)

Effective July 1, 2003, the EUTF replaced the Hawaii Public Employees Health Fund under Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county employees, retirees, and their dependents.

3. Cost of Retirement Benefits

The Department's general fund share of the expense for pension and post-retirement benefits for the year ended June 30, 2004 are paid from the State General Fund and approximate \$7,604,738 (note A13). The Department's special revenue fund and proprietary fund share of the pension and post-retirement benefits expense for the year ended June 30, 2004 was approximately \$3,668,896 and \$168,180, respectively, and are included in the Department's basic financial statements.

NOTE F – LEASE OBLIGATIONS

The Department leases various office facilities and equipment on a long-term basis as provided for in the lease agreements. The following is a schedule of minimum future rentals on noncancelable operating leases at June 30, 2004:

| Year ending June 30, | <u>Amount</u> |
|----------------------|---------------------------|
| 2005 | \$ 751,410 |
| 2006 | 865,020 |
| 2007 | 471,720 |
| 2008 | 87,290 |
| 2009 | <u>—</u> |
| | <u><u>\$2,175,440</u></u> |

Total rent expense for 2004 reflected in the general and special revenue funds was \$2,221,258.

NOTE G – COMMITMENTS AND CONTINGENCIES

1. Deferred Compensation

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE G – COMMITMENTS AND CONTINGENCIES (continued)

1. Deferred Compensation (continued)

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation plan are not reported in the accompanying basic financial statements.

2. Litigation

The Department is a party to various legal proceedings, most of which normally occur in governmental operations. Although the Department and its counsel are unable to express opinions as to the outcome of the litigation, it is the Department's opinion that any potential liability arising therefrom, will not have a material adverse effect on the financial position of the Department because any judgments against the Department are judgments against the State and generally are paid by legislative appropriation from the State General Fund and not by the Department.

3. Ceded Land

The Office of Hawaiian Affairs (OHA) and the State of Hawaii are presently in litigation involving the State's alleged failure to properly account for and pay to OHA monies due to OHA under the provisions of the Hawaii State Constitution and Chapter 10 of the Hawaii Revised Statutes for use by the State of certain ceded lands. As of June 30, 2004, the outcome of the lawsuit had not been decided.

NOTE H – TRANSFERS

For the year ended June 30, 2004, transfers by fund were as follows:

| | <u>Transfers in</u> | <u>Transfers out</u> |
|--|---------------------|----------------------|
| Governmental Funds | | |
| Tobacco settlement | \$ — | \$ 8,826,064 |
| Other funds | 100,000 | 4,318,970 |
| | <u>\$ 100,000</u> | <u>\$13,045,034</u> |
| Proprietary Funds | | |
| Water Pollution Control Revolving Fund | \$2,086,000 | \$ — |
| Drinking Water Treatment Revolving Loan Fund | 1,611,000 | — |
| | <u>\$3,697,000</u> | <u>\$ —</u> |

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE H – TRANSFERS (continued)

The tobacco settlement fund transferred \$8,826,064 to the Department of Budget and Finance as authorized by Act 177, Legislative Session of 2002.

Transfers out of other funds includes \$3,697,000 transferred to the proprietary funds relating to the State's matching of federal funds received from the Environmental Protection Agency. The remaining transfers in/out of nonmajor funds were made to/from other State agencies to fund various programs and services.

NOTE I – BEGINNING FUND BALANCE/NET ASSETS ADJUSTMENTS

Net assets of governmental activities at July 1, 2003 have been restated to reflect the correction of an understatement in accrued vacation of \$3,097,507. The following reconciles the June 30, 2003 net assets, as previously reported, to the beginning net assets as restated, to reflect prior-period adjustment:

| | <u>Governmental activities</u> | <u>Business-type activities</u> | <u>Total</u> |
|---|------------------------------------|-------------------------------------|----------------------|
| Net assets at July 1, 2003, as previously reported | \$158,079,286 | \$277,692,872 | \$435,772,158 |
| Prior-period adjustment for fringe benefits on accrued vacation | <u>(3,097,507)</u> | <u>—</u> | <u>(3,097,507)</u> |
| Net assets at July 1, 2003, as restated | <u>\$154,981,779</u> | <u>\$277,692,872</u> | <u>\$432,674,651</u> |

The effect of the adjustment is to decrease the 2003 change in net assets by \$1,601,505.

REQUIRED SUPPLEMENTARY INFORMATION
OTHER THAN MANAGEMENT'S DISCUSSION AND ANALYSIS

State of Hawaii
Department of Health

BUDGETARY COMPARISON SCHEDULE –
GENERAL FUND

Year ended June 30, 2004

| | <u>Budgeted amounts</u> | | <u>Actual amounts</u> |
|---|-------------------------|-----------------------|--------------------------|
| | <u>Original</u> | <u>Final</u> | <u>(budgetary basis)</u> |
| | | | <u>(see note A)</u> |
| Revenues | | | |
| Current-year appropriations | <u>\$ 345,392,213</u> | <u>\$ 346,462,954</u> | <u>\$ 341,001,734</u> |
| Total revenues | 345,392,213 | 346,462,954 | 341,001,734 |
| Expenditures | | | |
| General administration | 16,326,984 | 16,326,984 | 15,818,240 |
| Environmental health administration | 16,511,307 | 16,379,832 | 15,745,576 |
| Behavioral health services administration | 172,599,491 | 173,189,526 | 169,468,160 |
| Health resources administration | <u>139,954,431</u> | <u>140,566,612</u> | <u>139,969,758</u> |
| Total expenditures | <u>345,392,213</u> | <u>346,462,954</u> | <u>341,001,734</u> |
| EXCESS OF REVENUES OVER EXPENDITURES | <u><u>\$ -</u></u> | <u><u>\$ -</u></u> | <u><u>\$ -</u></u> |

State of Hawaii
Department of Health

BUDGETARY COMPARISON SCHEDULE –
TOBACCO SETTLEMENT FUND

Year ended June 30, 2004

| | <u>Budgeted amounts</u> | | <u>Actual amounts</u> |
|---|-------------------------|----------------------|------------------------------|
| | <u>Original</u> | <u>Final</u> | <u>(budgetary basis)</u> |
| | | | <u>(see note A)</u> |
| Revenues | | | |
| Current-year funds | <u>\$ 50,342,603</u> | <u>\$ 50,342,603</u> | <u>\$ 39,092,291</u> |
| Total revenues | 50,342,603 | 50,342,603 | 39,092,291 |
| Expenditures | | | |
| Health resources administration | <u>50,342,603</u> | <u>50,342,603</u> | <u>42,103,000</u> |
| Total expenditures | <u>50,342,603</u> | <u>50,342,603</u> | <u>42,103,000</u> |
| EXCESS OF EXPENDITURES OVER REVENUES | <u><u>\$ -</u></u> | <u><u>\$ -</u></u> | <u><u>\$ (3,010,709)</u></u> |

State of Hawaii
Department of Health

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

Year ended June 30, 2004

NOTE A - Explanation of Differences between Budgetary Actual and GAAP Revenues
and Expenditures

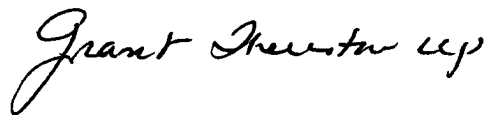
| | <u>General Fund</u> | <u>Tobacco Settlement Fund</u> |
|--|------------------------------|--|
| Excess of expenditures over revenues and other sources and uses - actual on a budgetary basis | \$ - | \$ (3,010,709) |
| Reserve for encumbrances at year end | 34,814,634 | 7,031,134 |
| Expenditures for liquidation of prior year's encumbrances | (40,418,604) | (9,266,056) |
| Accrual and other adjustments | <u>833,319</u> | <u>9,500,693</u> |
| EXCESS (DEFICIENCY) OF REVENUE OVER EXPENDITURES - US GAAP BASIS | <u><u>\$ (4,770,651)</u></u> | <u><u>\$ 4,255,062</u></u> |

SUPPLEMENTARY INFORMATION

Report of Independent Certified Public Accountants
on Supplementary Information

Director of Health
Department of Health
State of Hawaii

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Department of Health, State of Hawaii (Department), basic financial statements. The accompanying Schedule of Expenditures of Federal Awards, on pages 51 through 60 is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.



Honolulu, Hawaii
March 14, 2005

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year ended June 30, 2004

| Federal grantor/pass-through grantor/program title | Project number | CFDA, contract, award or assistance ID number | Pass-through entity identifying number | Federal expenditures | Amount provided to subrecipient |
|--|-------------------|--|---|-------------------------|---------------------------------------|
| <u>Department of Health and Human Services (DHHS)</u> | | | | | |
| Direct Programs | | | | | |
| Bioterrorism Hospital Preparedness | 435 | 93.003 | | \$ 459,924 | \$ - |
| OAA - LTC Ombudsman | 468 | 93.042 | | 118,488 | |
| Special Programs for Aging – Title VII Chapter 3 | 401 | 93.041 | | 25,838 | |
| Special Programs for Aging – Title VII Chapter 2 | 401 | 93.042 | | 59,665 | |
| Special Programs for Aging – Title III Part B | 401 | 93.044 | | 2,030,989 | |
| Special Programs for Aging – Title III Part C1 | 401 | 93.045 | | 1,730,047 | |
| Special Programs for Aging – Title III Part C2 | 401 | 93.045 | | 742,699 | |
| Special Programs for Aging – Title III Part D | 401 | 93.046 | | 98,691 | |
| Special Programs for Aging – Title III Part E | 401 | 93.043 | | 692,868 | |
| Special Programs for Aging – Title IV | 405 | 93.048 | | 155,074 | |
| | | | | <u>5,535,871</u> | |
| Genetics Services - State Development | 425 | 93.110A | | 186,511 | |
| Genetics Services | 426 | 93.110A | | 265,893 | |
| | | | | <u>452,404</u> | |
| Maternal and Child Health Federal Consolidated Programs | 307 | 93.110 | | 68,568 | |
| CISS - SECCS (Planning) | 466 | 93.110 | | 24,468 | |
| Integrated Comprehensive Women's Health Services in State MCH Program | 282 | 93.110AK | | 26,021 | |
| Healthy Child Care Hawaii | 419 | 93.110AQ | | 42,669 | |
| Project Grants and Cooperative Agreements for Tuberculosis Control Programs | 247 | 93.116 | | 1,017,695 | - |
| Emergency Medical Services for Children System Enhancements | 388 | 93.127C | | 332,246 | |
| Primary Care Services – Resource Coordination and Development Primary Care Offices | 298 | 93.130 | | 146,905 | |
| Subtotal carried forward | | | | \$ 8,225,259 | \$ - |

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2004

| Federal grantor/pass-through grantor/program title | Project number | CFDA, contract, award or assistance ID number | Pass-through entity identifying number | Federal expenditures | Amount provided to subrecipient |
|--|-------------------|--|---|-------------------------|---------------------------------------|
| Subtotal brought forward | | | | \$ 8,225,259 | \$ - |
| Rape Prevention and Education | 440 | 93.136 | | 149,895 | |
| Core State Injury Surveillance and Development | 450 | 93.136 | | 79,205 | 41,890 |
| Violence Against Women Planning | 451 | 93.136 | | 26,415 | |
| Projects for Assistance in Transition from Homelessness (PATH) | 15208 | 93.150 | | 159,260 | |
| | 16208 | 93.150 | | 110,769 | |
| | | | | <u>270,029</u> | 165,871 |
| Childhood Lead Poisoning Prevention and Surveillance of Blood Lead Levels in Children | 215 | 93.197 | | 72,139 | - |
| Hansen's Disease National Ambulatory Care Program | 264 | 93.215 | | 518,269 | |
| Family Planning – Services | 239 | 93.217 | | 1,989,141 | 928,578 |
| Hawaii Youth Substance Abuse Prevention | 421 | 93.230 | | 2,515,751 | 353,115 |
| Enhancement of the Data Infrastructure for the Mental Health Grants | 430 | 93.230 | | 68,335 | |
| Traumatic Brain Injury | 434 | 93.234A | | 137,279 | 63,731 |
| Abstinence Education Initiative | 273 | 93.235 | | 116,523 | 69,504 |
| Enhanced Birth Defect Surveillance | 276 | 93.238 | | 153,300 | |
| Hawaii State Data Infrastructure Program | 455 | 93.238 | | 58,607 | |
| Rural Hospital Flexibility Program | 415 | 93.241 | | 313,731 | |
| Subtotal carried forward | | | | \$ 14,693,878 | \$ 1,622,689 |

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2004

| Federal grantor/pass-through grantor/program title | Project number | CFDA, contract, award or assistance ID number | Pass-through entity identifying number | Federal expenditures | Amount provided to subrecipient |
|---|-------------------|--|---|-------------------------|---------------------------------------|
| Subtotal brought forward | | | | \$ 14,693,878 | \$ 1,622,689 |
| Implement Post Booking Jail | 461 | 93.243 | | 307,338 | |
| Development of Disaster Preparedness and Emergency | 464 | 93.243 | | 54,284 | |
| Hawaii's COSIG for Treatment of Persons with Co-Occuring Substance Related and Mental Disorders | 471 | 93.243 | | 66,340 | |
| Introduction of Co-Occuring Disorders and Illness | 474 | 93.243 | | 17,772 | |
| Universal Newborn Hearing Screening | 416 | 93.251 | | 73,417 | |
| TB Epidemiologic Studies Consortium | 437 | 93.256 | | 24,164 | |
| State Planning Grant Proposal | 439 | 93.256 | | 489,826 | 88,132 |
| Rural Access to Emergency Devices | 453 | 93.259 | | 10,000 | |
| Childhood Immunization Grants | 269 | 93.268 | | 469,547 | 33,304 |
| Immunization & Vaccines for Children | 457 | 93.268 | | 2,203,495 | |
| Tobacco Prevention and Control Program | 205 | 93.283 | | 285,145 | |
| Behavioral Risk Factor Surveillance System | 202 | 93.283 | | 920 | |
| Chronic Disease Prevention and Health Promotion Programs | 465 | 93.283 | | 623,910 | |
| Hawaii DOPH for an Assessment of Health Effects Assoc. with Volcanic Emission | 241 | 93.283 | | 122,348 | |
| Epidemiology and Laboratory Surveillance and Response | 267 | 93.283 | | 930,318 | 152,552 |
| Public Health Preparedness & Response for Bioterrorism | 1297 | 93.283 | | 6,518,372 | |
| Pregnancy Risk Assessment Monitoring System | 319 | 93.283 | | 133,882 | |
| Early Hearing Detection and Intervention Tracking Research | 422 | 93.283 | | 186,074 | |
| Community Health Promotions | 442 | 93.283 | | 282,629 | |
| Addressing Asthma | 444 | 93.283 | | 153,733 | |
| National Cancer Prevention & Control | 448 | 93.283 | | 1,019,292 | 521,894 |
| Community Health Centers Hawaii - Childhood Rural Asthma Project | 472 | 93.283 | | 10,956 | |
| Subtotal carried forward | | | | \$ 28,677,640 | \$ 2,418,571 |

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2004

| Federal grantor/pass-through grantor/program title | Project number | CFDA, contract, award or assistance ID number | Pass-through entity identifying number | Federal expenditures | Amount provided to subrecipient |
|---|-------------------|--|---|-------------------------|---------------------------------------|
| Subtotal brought forward | | | | \$ 28,677,640 | \$ 2,418,571 |
| Small Rural Hospital Improvement | 454 | 93.301 | | 177,879 | |
| Child Care and Development Block Grant | 244 | 93.575 | | 195,322 | |
| Community-Based Family Resource and Support Grants | 270 | 93.590 | | 490,964 | 21,800 |
| Developmental Disabilities Basic Support and Advocacy Grants | 240 | 93.630 | | 446,955 | |
| Family Support Demonstration | 445 | 93.631 | | 62,092 | |
| Clinical Laboratory Improvement Amendments Program | 380 | 93.777 | | 91,360 | |
| State Survey and Certification of Health Care Providers and Suppliers | 221 | 93.777 | | 1,181,804 | |
| Health Care Financing Research, Demonstrations and Evaluations | 403 | 93.779 | | 122,769 | |
| Hawaii Community Pass Project | 452 | 93.779 | | 84,092 | |
| Grants to States for Operation of Offices of Rural Health | 299 | 93.913 | | 67,175 | |
| HIV Care Formula Grants | 293 | 93.917 | | 3,379,133 | 52,385 |
| Comprehensive Breast & Cervical Cancer Early Detection Program | 348 | 93.919 | | 33,378 | 440,754 |
| Healthy Start Phase II, Eliminating Racial / Ethnic Disparities | 253 | 93.926E | | 782,712 | |
| Improving Women's Health for Depression | 428 | 93.926L | | 156,910 | |
| HIV Prevention Project | 266 | 93.940 | | 2,248,223 | 257,861 |
| HIV/AIDS Surveillance and Seroprevalence Project | 272 | 93.944 | | 210,149 | |
| Subtotal carried forward | | | | \$ 38,408,557 | \$ 3,191,371 |

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2004

| Federal grantor/pass-through grantor/program title | Project number | CFDA, contract, award or assistance ID number | Pass-through entity identifying number | Federal expenditures | Amount provided to subrecipient |
|--|-------------------|--|---|-------------------------|---------------------------------------|
| Subtotal brought forward | | | | \$ 38,408,557 | \$ 3,191,371 |
| Improving Contact Investigations in Foreign Born Populations | 427 | 93.947 | | 125,924 | |
| Trauma - Emergency Medical Services | 443 | 93.952 | | 10,715 | |
| Olmstead Financial Support Award | 242 | 93.958 | | 14,409 | |
| Block Grants for Community Mental Health Services | 20202 | 93.958 | | 25,577 | |
| | 21202 | 93.958 | | 174,595 | |
| | 22202 | 93.958 | | 1,114,290 | |
| | 23202 | 93.958 | | 256,110 | |
| | | | | <u>1,570,572</u> | 505,656 |
| Substance Abuse Prevention and Treatment Block Grant | 21204 | 93.959 | | 770,396 | |
| | 22204 | 93.959 | | 6,309,926 | |
| | | | | <u>7,080,322</u> | 5,100,825 |
| Preventive Health Services – Sexually Transmitted Diseases Control Grants | 268 | 93.977 | | 403,416 | |
| Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems | 261 | 93.988 | | 393,695 | |
| Preventive Health and Health Services Block Grants | 20203 | 93.991 | | 14,771 | |
| | 21203 | 93.991 | | 69,544 | |
| | 22203 | 93.991 | | 803,615 | |
| | 23203 | 93.991 | | 3,974 | |
| | | | | <u>891,904</u> | |
| Maternal and Child Health Services Block Grant | 21201 | 93.994 | | 268,563 | |
| | 22201 | 93.994 | | 1,995,845 | |
| | 23201 | 93.994 | | 87,021 | |
| | | | | <u>2,351,429</u> | 82,170 |
| Hawaii Telemedicine Planning Initiative | 206 | 15-50-96046 | | 36,155 | |
| Subtotal carried forward | | | | \$ 51,287,098 | \$ 8,880,022 |

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2004

| Federal grantor/pass-through grantor/program title | Project number | CFDA, contract, award or assistance ID number | Pass-through entity identifying number | Federal expenditures | Amount provided to subrecipient |
|---|----------------|--|---|-------------------------|---------------------------------------|
| Subtotal brought forward | | | | \$ 51,287,098 | \$ 8,880,022 |
| Vital Statistics Cooperative Program | 285 | 200-89-7211 | | 101,952 | |
| Statistics of American Indians Residing in Hawaii | 291 | Not Available | | 20,029 | |
| Drug and Alcohol Services Information System | 371 | Not available | | 28,928 | - |
| Subtotal Direct Programs | | | | 51,438,007 | 8,880,022 |
| Pass-through from the Commonwealth of Kentucky | | | | | |
| Medicare, Pacific Area | 384 | Not available | | 19,320 | |
| Medicare, OASIS | 387 | Not available | | 1,813 | |
| Subtotal Pass-through from the Commonwealth of Kentucky | | | | 21,133 | |
| TOTAL DEPARTMENT OF HEALTH AND HUMAN SERVICES | | | | 51,459,140 | 8,880,022 |
| <u>Department of Agriculture</u> | | | | | |
| Direct Program | | | | | |
| Special Supplemental Nutrition Program for Women, Infants, and Children | 275 | 10.557 | | 28,135,691 | 1,547,697 |
| Nutrition Program for the Elderly | 406 | 10.570 | | 520,019 | |
| Epidemiology Partnership Project with the Food Safety and Inspection Service | 238 | Not available | | 8,052 | |
| TOTAL DEPARTMENT OF AGRICULTURE | | | | 28,663,762 | 1,547,697 |
| <u>Environmental Protection Agency</u> | | | | | |
| Direct Programs | | | | | |
| Air Pollution Control Program Support | 233 | 66.001 | | 729,610 | |
| Clean Air Act Session 103 - Air Toxics Monitoring Report | 456 | 66.034 | | 14,343 | |
| Water Pollution Control – State and Interstate Program Support (Section 106 Grants) | 231 | 66.419 | | 1,881,668 | |
| | 237 | 66.419 | | 170,795 | |
| | | | | 2,052,463 | 33,034 |
| Subtotal carried forward | | | | \$ 2,796,416 | \$ 33,034 |

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2004

| Federal grantor/pass-through grantor/program title | Project number | CFDA, contract, award or assistance ID number | Pass-through entity identifying number | Federal expenditures | Amount provided to subrecipient |
|---|-------------------|--|---|-------------------------|---------------------------------------|
| Subtotal brought forward | | | | \$ 2,796,416 | \$ 33,034 |
| State Public Water System Supervision | 232 | 66.432 | | 512,933 | |
| Water Quality Management Program | 9284 | 66.454 | | 54,108 | |
| | 10284 | 66.454 | | 45,539 | |
| | | | | <u>99,647</u> | 166,197 |
| Capitalization Grants for State Revolving Funds | 4206 - 15206 | 66.458 | | 19,837,820 | 3,747,894 |
| Nonpoint Source Implementation Grants | 3290 | 66.460 | | 427,021 | |
| | 4290 | 66.460 | | 175,218 | |
| | 5289 | 66.460 | | 48,354 | |
| | 6289 | 66.460 | | 367,136 | |
| | 7289 | 66.460 | | 203,192 | |
| | | | | <u>1,220,921</u> | |
| Beach Monitoring and Notification Program | 431 | 66.472 | | 49,517 | |
| Water Protection Coordination | 449 | 66.474 | | 30 | |
| Capitalization Grants for Drinking Water State Revolving Fund | 1207-7207 | 66.468 | | 7,008,295 | 2,994,527 |
| Macroalgal Blooms | 2236 | 66.606 | | 34,216 | |
| Subtotal carried forward | | | | \$ 31,559,795 | \$ 6,941,652 |

Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2004

| Federal grantor/pass-through grantor/program title | Project number | CFDA, contract, award or assistance ID number | Pass-through entity identifying number | Federal expenditures | Amount provided to subrecipient |
|---|-------------------|--|---|-------------------------|---------------------------------------|
| Subtotal brought forward | | | | \$ 31,559,795 | \$ 6,941,652 |
| Clean Air Act | 252 | 66.606 | | 20,555 | |
| PM 2.5 Monitoring Network | 294 | 66.606 | | 218,252 | |
| Air Toxics Monitoring Project | 429 | 66.606 | | 1,290 | |
| Water Infrastructure Oversight | 460 | 66.606 | | 2,173 | |
| Environmental Information Exchange Grant Program | 467 | 66.608 | | 87 | |
| Toxic Substances Compliance Monitoring Cooperative Agreements | 243 | 66.701 | | 181,408 | |
| State Lead Program | 330 | 66.707 | | 141,788 | |
| Capacity Building for States and Tribes - Establishing the Compliance Database and AFS-UI for Hawaii | 462 | 66.709 | | 284 | |
| Hazardous Waste Management State Program Support | 230 | 66.801 | | 501,727 | |
| Preliminary Assessment/Site Inspection Program | 249 | 66.802 | | 156,262 | |
| Kakaako Park Brownfields | 228 | 66.802 | | 83,096 | |
| Super Fund Core Program | 259 | 66.802 | | 271,525 | |
| Voluntary Clean-up Program | 335 | 66.802 | | 126,920 | |
| | | | | 637,803 | 48,610 |
| State Underground Storage Tanks Program (UST Program) | 220 | 66.804 | | 200,107 | |
| Leaking Underground Storage Tank (LUST) Trust Fund Program | 258 | 66.805 | | 415,977 | |
| Model State Bottle Bill Project | 289 | 66.808 | | 5,700 | |
| Development of a Lamp Recycling Outreach Program in Hawaii | 447 | 66.808 | | 3,903 | |
| FY 04 State Response Program | 469 | 66.817 | | 167,977 | |
| TOTAL ENVIRONMENTAL PROTECTION AGENCY | | | | \$ 34,058,826 | \$ 6,990,262 |

Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2004

| Federal grantor/pass-through grantor/program title | Project number | CFDA, contract, award or assistance ID number | Pass-through entity identifying number | Federal expenditures | Amount provided to subrecipient |
|---|-------------------|--|---|-------------------------|---------------------------------------|
| <u>Department of Education (ED)</u> | | | | | |
| Pass through from the State Department of Education | | | | | |
| Grants for Infants and Toddlers With Disabilities | 213 | 84.181 | | \$ 2,028,350 | \$ 328,766 |
| State Improvement Grant - Early Intervention | 441 | Not available | | 17,002 | |
| TOTAL DEPARTMENT OF EDUCATION | | | | 2,045,352 | 328,766 |
| <u>Department of Defense (DOD)</u> | | | | | |
| Direct Program | | | | | |
| Defense Environmental Restoration Program | 245 | 12.113 | | 150,849 | |
| FYE State Homeland Security Grant (MOA) | 469 | 66.817 | | 116,846 | |
| TOTAL DEPARTMENT OF DEFENSE | | | | 267,695 | - |
| <u>Department of Justice (DOJ)</u> | | | | | |
| Direct Program | | | | | |
| FY 01 Enforcing Underage Drinking | 438 | 16.727 | | 276,022 | - |
| FY 03 Enforcing Underage Drinking | 458 | 16.727 | | 23,806 | - |
| TOTAL DEPARTMENT OF JUSTICE | | | | 299,828 | - |

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2004

| Federal grantor/pass-through grantor/program title | Project number | CFDA, contract, award or assistance ID number | Pass-through entity identifying number | Federal expenditures | Amount provided to subrecipient |
|---|-------------------|--|---|-------------------------|---------------------------------------|
| <u>Department of Transportation (DOT)</u> | | | | | |
| Direct Programs | | | | | |
| Underage Drinking Prevention | 473 | Not available | | \$ 23,108 | |
| Highway Safety grants | 476 | Not available | | 151,381 | |
| Subtotal Direct Programs | | | | 174,489 | |
| Pass-through from the State Department of Transportation | | | | | |
| KIPC Oahu Department of Transportation Program | Not available | 20.600 | | 43,820 | |
| KIPC Big Island Department of Transportation Program | Not available | 20.600 | | 38,500 | |
| KIPC Kauai Department of Transportation Program | Not available | 20.600 | | 75,400 | |
| Subtotal pass-through from the State Department of Transportation | | | | 157,720 | |
| TOTAL DEPARTMENT OF TRANSPORTATION | | | | 332,209 | - |
| <u>Oregon Health and Science University</u> | | | | | |
| Hawaii NFATTC | 432 | Not available | | 55,040 | |
| TOTAL OREGON HEALTH AND SCIENCE UNIVERSITY | | | | 55,040 | - |
| <u>ATPM</u> | | | | | |
| Breastfeeding Special Report | 433 | Not available | | 17,297 | |
| TOTAL ATPM | | | | 17,297 | - |
| TOTAL FEDERAL FINANCIAL ASSISTANCE | | | | \$ 117,199,149 | \$ 17,746,747 |

State of Hawaii
Department of Health

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year ended June 30, 2004

NOTE 1 – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Department of Health, State of Hawaii (Department), and is presented on the cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE 2 – LOANS OUTSTANDING

The Department had the following loan balances outstanding at June 30, 2004. Loans made during the year are included in the federal expenditures presented in the schedule.

| <u>Program title</u> | <u>Federal CFDA number</u> | <u>Amount outstanding</u> |
|---|--------------------------------|-------------------------------|
| Capitalization Grants for State Revolving Funds | 66.458 | \$127,194,708 |
| Capitalization Grants for Drinking Water State Revolving Funds | 66.468 | 13,599,048 |

PART II
REPORTS ON COMPLIANCE AND INTERNAL CONTROL

STATE OF HAWAII
DEPARTMENT OF HEALTH

June 30, 2004

Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an
Audit of the Financial Statements Performed in
Accordance with *Government Auditing Standards*

Director of Health
State of Hawaii

We have audited the financial statements of the Department of Health, State of Hawaii, as of and for the year ended June 30, 2004, and have issued our report thereon dated March 14, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the Auditing Standards Board of the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department of Health, State of Hawaii's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Accordingly, we express no such opinion. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department of Health, State of Hawaii's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as item 04-01.

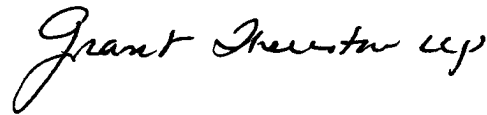
A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Director of Health
State of Hawaii

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department of Health, State of Hawaii's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, including applicable provisions of Hawaii Public Procurement Code (Chapter 103D of Hawaii Revised Statutes) and Procurement Rules, Directives and Circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. We noted certain matters that we reported to management of the Department of Health, State of Hawaii in a separate letter dated March 14, 2005.

This report is intended solely for the information and use of the Department of Health, State of Hawaii, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, reading "Grant Stewart" followed by a stylized flourish.

Honolulu, Hawaii
March 14, 2005

Report on Compliance With Requirements Applicable
to Each Major Program and on Internal Control Over
Compliance In Accordance With OMB Circular A-133

Director of Health
State of Hawaii

Compliance

We have audited the compliance of the Department of Health, State of Hawaii (Department), with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2004. The Department's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America as established by the Auditing Standards Board of the American Institute of Certified Public Accountants; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Department's compliance with those requirements.

In our opinion, the Department complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2004. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 04-02 to 04-04.

Director of Health
State of Hawaii

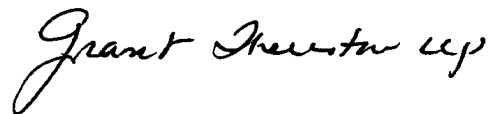
Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133 and not to provide an opinion on the internal control over compliance. Accordingly, we express no such opinion.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Department's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 04-02 to 04-04.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 04-02 and 04-04 to be a material weakness.

This report is intended solely for the information and use of the Department and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, reading "Grant Stewart" followed by a stylized flourish.

Honolulu, Hawaii
March 14, 2005

PART III
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

STATE OF HAWAII
DEPARTMENT OF HEALTH

June 30, 2004

State of Hawaii
Department of Health

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the year ended June 30, 2004

Section I – Summary of Auditor’s Results

Our report dated March 14, 2005 on the combined financial statements of the Department of Health, State of Hawaii, as of and for the year ended June 30, 2004, contained an unqualified opinion.

Financial Statements

Type of auditor’s report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? ☐ Yes ☒ No
- Reportable condition(s) identified that are not considered to be material weaknesses? ☒ Yes ☐ None reported

Noncompliance material to financial statements noted? ☐ Yes ☒ No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? ☒ Yes ☐ No
- Reportable condition(s) identified that are not considered to be material weakness(es)? ☐ Yes ☒ None reported

Type of auditor’s report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?

☒ Yes ☐ No

State of Hawaii
Department of Health

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

For the year ended June 30, 2004

Identification of major programs:

| <u>CFDA Number(s)</u> | <u>Name of Federal Program or Cluster</u> |
|---------------------------|---|
| | U.S. Department of Health & Human Services |
| 93.044/93.045 | Special Programs for Aging – Title III, Parts B and C |
| 93.283 | Public Health Preparedness & Response for Bioterrorism |
| 93.777 | State Survey and Certification of Health Care Providers and Suppliers |
| 93.959 | Substance Abuse Prevention & Treatment Block Grant |
| | U.S. Department of Agriculture |
| 10.557 | Special Supplemental Nutrition Program for Women, Infants & Children |
| | U.S. Environmental Protection Agency |
| 66.458 | Capitalization Grants for State Revolving Funds |
| 66.468 | Capitalization Grants for Drinking Water State Revolving Fund |

Dollar threshold used to distinguish between type A and
type B programs:

\$2,710,591

Auditee qualified as low-risk auditee?

☐ Yes ☒ No

Section II – Financial Statement Findings

A. Fixed Assets

(Ref #04-01)

Because State properties are purchased with public monies, employees of the State have an obligation to the public for the accountability of State properties. According to the “Department of Accounting and General Services – State Procurement Office – Inventory Management Branch Training” manual, property custodians are responsible for reporting and updating inventory balances each quarter. However, during our testing of fixed assets, we noted that various locations did not report fixed asset additions on a timely basis.

We recommend that Department personnel ensure that policies and procedures in the State Inventory Manual are being followed. In addition, we recommend that the Department implement a procedure for property custodians to reconcile equipment acquisitions in the FAMIS reports to the MDB reports

State of Hawaii
Department of Health

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

For the year ended June 30, 2004

(DAGS computerized inventory reports) on a timely basis. Timely reconciliations are highly cost efficient since reconciliation at a later date is often more difficult and time consuming.

Section III – Federal Award Findings and Questioned Cost

A. Public Health Preparedness & Response for Bioterrorism (CFDA 93.283)

Equipment Management

(Ref #04-02)

During prior engagements, we noted that an equipment inventory had not been taken at least once in 2 years. Although the program has implemented extensive procedures to take an annual physical inventory, we noted some equipment acquisitions were not recorded in inventory reports for a total amount of \$57,176.

We recommend that the program ensure that procedures to report equipment acquisitions on a timely basis are understood and followed by program personnel.

B. State Survey and Certification of Health Care Providers and Suppliers (CFDA 93.777)

Reporting

(Ref #04-03)

During our testing of the CMS 435 State Survey Agency Budget/Expenditure Report, it was noted that an incorrect rate was used to compute the period's indirect cost expense. The prior period rate was used instead of the current period rate.

We recommend that the Department implement review procedures to ensure that information presented on required reports is complete and accurate before it is submitted to the Federal oversight agency.

State of Hawaii
Department of Health

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

For the year ended June 30, 2004

C. Capitalization Grants for Drinking Water State Revolving Fund (CFDA 66.468)

Matching

(Ref #04-04)

In the case of the State Program Management set-aside (40CFR 35.3535(d)(2) and 35.3550(h)), the State must provide an amount equal to 100% of the set-aside. The sources of these additional funds can be State monies or documentation of in-kind services. Although the program met the 1:1 State Program Management requirement, we noted that the program does not monitor its State monies to ensure that it is in compliance with the requirement.

A budget is sent to the EPA; however, actual State and Federal expenditures are combined and not differentiated. We recommend that the State segregate the State expenditures from the Federal expenditures to ensure that the State funds spent, or set-aside is equal to, or exceeds the Federal funds.

PART IV
RESPONSE OF THE AFFECTED AGENCY
(provided by Department of Health, State of Hawaii)

STATE OF HAWAII
DEPARTMENT OF HEALTH

June 30, 2004

LINDA LINGLE
GOVERNOR OF HAWAII



CHIYOME LEINAALA FUKINO, M.D.
DIRECTOR OF HEALTH

STATE OF HAWAII
DEPARTMENT OF HEALTH
P.O. BOX 3378
HONOLULU, HAWAII 96801-3378

In reply, please refer to:
File #
ASO-F-3540

March 29, 2005

Grant Thornton LLP
1132 Bishop Street, Suite 1000
Honolulu, HI 96813

Dear Grant Thornton:

Attached are the Department of Health's Correction Action Plan to the findings on the audit report for fiscal year 2004 and comments regarding prior year findings.

We appreciate the opportunity to comment on the audit report.

Sincerely,

A handwritten signature in black ink, appearing to read "Chiyome Leinaala Fukino".

Chiyome Leinaala Fukino, M.D.
Director of Health

Attachment

FINANCIAL STATEMENT FINDINGS – FY 2004

A. Fixed Assets

(Ref #04-01)

Because State properties are purchased with public monies, employees of the State have an obligation to the public for the accountability of State properties. According to the “Department of Accounting and General Services – State Procurement Office – Inventory Management Branch Training” manual, property custodians are responsible for reporting and updating inventory balances each quarter. However, during our testing of fixed assets, we noted that various locations did not report fixed asset additions on a timely basis.

Corrective Action Plan

This oversight was addressed in February 2005 as the DOH received the SPO inventory listings to reconcile with FAMIS transactions for FY 2004. The department is currently having all division property custodians reconcile the equipment acquisitions in the FAMIS reports to the DAGS computerized inventory reports. This report is due back to the DAGS – SPO by April 15, 2005.

Person Responsible

Acting Chief Accountant

Anticipated Date of Completion

April 15, 2005 for FY 2004

FEDERAL AWARD FINDINGS AND QUESTIONED COST

A. Public Health Preparedness & Response for Bioterrorism (CFDA 93.283)

Equipment Management

(Ref #04-02)

During prior engagements, we noted that an equipment inventory had not been taken at least once in 2 years. Although the program has implemented extensive procedures to take an annual physical inventory, we noted some equipment acquisitions were not recorded in inventory reports for a total amount of \$57,176.

Corrective Action Plan

With the department’s compliance with the DAGS – SPO equipment annual reconciliation to FAMIS expenditures as noted above (#04-01), similar omissions will

not occur as these errors and oversights will be noted and corrected. The program will continue to utilize its inventory control procedures to do the annual physical inventory audits.

Person Responsible

Bioterrorism Program Accountant

Anticipated Date of Completion

April 15, 2005

B. State Survey and Certification of Health Care Providers and Supplies (CFDA 93.777)

Reporting

(Ref #04-03)

During our testing of the CMS 435 State Survey Agency Budget/Expenditure Report, it was noted that an incorrect rate was used to compute the period's indirect cost expense. The prior period rate was used instead of the current period rate.

Corrective Action Plan

The ASO Accountant in Fiscal Services will reference the current year indirect rate sheet to ensure that the correct indirect cost rate is used for all proposals and grants.

Person Responsible

Accountant V

Anticipated Date of Completion

March 29, 2005

C. Capitalization Grants for Drinking Water State Revolving Fund (CFDA 66.468)

Matching

(Ref. # 04-04)

In the case of the State Program Management set-aside (40CFR 35.3535(d)(2) and 35.3550 (h)), the State must provide an amount equal to 10% of the set-aside. The sources of these additional funds can be State monies or documentation of in-kind services. Although the program met the 1:1 State Program Management

requirement, we noted that the program does not monitor its State monies to ensure that it is in compliance with the requirement.

Corrective Action Plan

The program is still working to complete the tracking of all state funds and in-kind resources needed to match the 10% set-aside.

Person Responsible

Chief, Safe Drinking Water Branch

Anticipated Date of Completion

June 30, 2005

PART V
COMMENTS REGARDING PRIOR FISCAL YEAR FINDINGS
(provided by Department of Health, State of Hawaii)

STATE OF HAWAII
DEPARTMENT OF HEALTH

June 30, 2004

COMMENTS REGARDING PRIOR FISCAL YEAR FINDINGS

FEDERAL AWARD FINDINGS

A. Special Programs for the Aging – Title III, Part B & C (CFDA 93.044 and 93.045)

1. Equipment Management (Ref. #03-01)

The auditors recommended that the Department reevaluate its policies and procedures to ensure equipment records are prepared accurately and updated on a timely basis in the future.

Status

Completed June 30, 2004.

2. Reporting (Ref. #03-02)

The auditors recommended that the Department reevaluate its policies and procedures to ensure supporting documentation for the SF-272 reports be maintained for a period of two years in the future.

Status

Completed

3. Subrecipient Monitoring (Ref. #03-03)

The auditors recommend that the annual on-site and fiscal assessment be performed for each county within six months of the end of the fiscal year.

Status

Completed

B. Centers for Disease Control and Prevention-Investigations and Technical Assistance (CFDA 93.283)

1. Equipment Management (Ref. #03-04)

The auditors recommended that the Department follow state policies and procedures regarding equipment inventory and take a physical inventory on an annual basis.

Status

On-going

C. Capitalization Grants for Drinking Water State Revolving Fund (CFDA 66.468)

1. Binding Commitments (Ref. #03-05)

The auditors recommended that the state employ marketing strategies to inform the counties of resources available for eligible construction projects. This will help the state to fulfill their binding commitment requirement.

Status

Completed March 2004

2. Equipment Management (Ref. #03-06)

The auditors recommended that the SDWB management ensure that fixed asset control policies and procedures are being followed and operating effectively.

Status

Completed July 31, 2004

3. Earmarking (Ref. #03-07)

The auditors recommended that the state segregate the state expenditures from the federal expenditures to ensure that the state funds spent, or set-aside are equal to, or exceed the federal funds.

Status

Ongoing with June 30, 2005 established as the new anticipated date of completion.